



CRAIG-HALLUM
CAPITAL GROUP LLC

Kevin Ellich
Senior Research Analyst
612-334-8228
kevin.ellich@craig-hallum.com

Per Ostlund, CFA
Senior Research Analyst
612-334-6353
per.ostlund@craig-hallum.com

www.craig-hallum.com

Changes	Previous	Current
Rating:	Buy	Hold
Fundamental Trend:	-	Mixed
Price Target:	\$44	\$34
FY17A Rev M:	-	\$2,836
FY18E Rev M:	\$3,040	\$3,030
FY19E Rev M:	\$3,244	\$3,213
FY17A EPS:	-	\$2.30
FY18E EPS:	\$2.54	\$2.52
FY19E EPS:	\$2.82	\$2.74

Profile		
Price:		\$35.48
52 Wk Range:	\$26.92	- \$45.27
Avg Daily Vol:	2,811,210	
Shares Out M:	87.5	
Market Cap M:	\$3,165	
Insiders Own:	2.2%	
Short Interest (M):	12.3	
Book Value/Sh:	\$30.66	
Est LT EPS Gr:	10%	
Dividend Yield (%):	0.0%	
Net Debt (M):	\$3,142	
Net Debt/Sh:	\$35.92	
Debt / Capital:	54.6%	
Year Ends:	Dec	

Rev (M)	2017A	2018E	2019E
Mar	\$679	\$742A	\$792
Jun	\$716	\$766A	\$810
Sep	\$717	\$748	\$792
Dec	\$725	\$775	\$819
FY	\$2,836	\$3,030	\$3,213

EPS *	2017A	2018E	2019E
Mar	\$0.46	\$0.52A	\$0.55
Jun	\$0.66	\$0.70A	\$0.76
Sep	\$0.58	\$0.63	\$0.69
Dec	\$0.61	\$0.67	\$0.74
FY	\$2.30	\$2.52	\$2.74

* Adjusted EPS			
P/E	15.4x	14.7x	13.0x
EV/Revenue	2.2x	2.1x	2.0x
EV/EBITDA	10.4x	9.9x	9.3x

Management	
CEO	Joey Jacobs
President	Brent Turner
CFO	David Duckworth

October 17, 2018
Institutional Research

Acadia Healthcare

(ACHC - \$35.48)

HOLD

Price Target: \$34

Downgrading To HOLD Rating As Growth And Leverage Likely Cap Valuation. Lowering Estimates, Price Target Reduced To \$34.

Acadia Healthcare is a facility-based behavioral healthcare company established in 2005 to operate, develop and acquire behavioral healthcare facilities in both the U.S. and U.K.

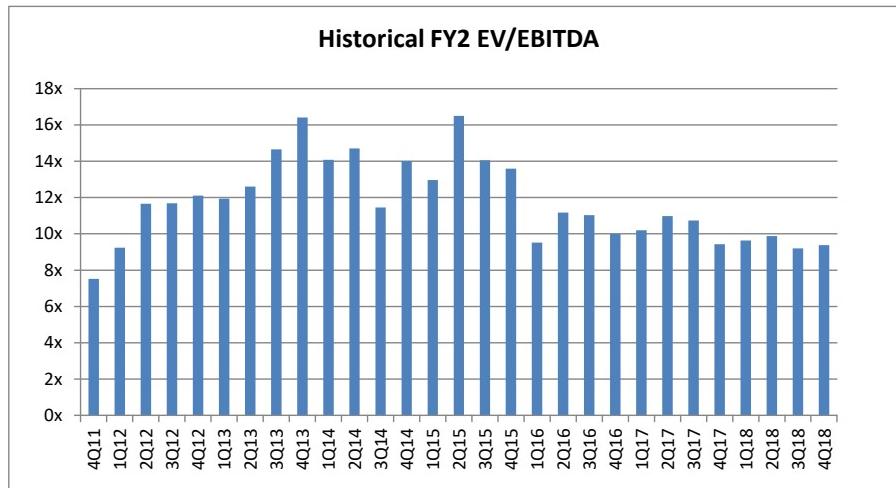
OUR CALL

We are lowering our rating on shares of Acadia Healthcare to Hold from Buy as we believe the risk/reward is no longer compelling. We think the stock will be range-bound due to: (1) the potential for growth to slow, (2) continued uncertainty in the U.K., and (3) leverage on the balance sheet and rising interest rates, which could negatively affect ACHC's cost of capital in the event that it decides to raise capital for future acquisitions. We also believe competition could make it more difficult to fill beds and recently published reports alleging abuse at ACHC facilities could heighten the regulatory environment and/or change referral behavior and negatively affect occupancy rates. We lowered our estimates and reduced our price target to \$34.

KEY POINTS

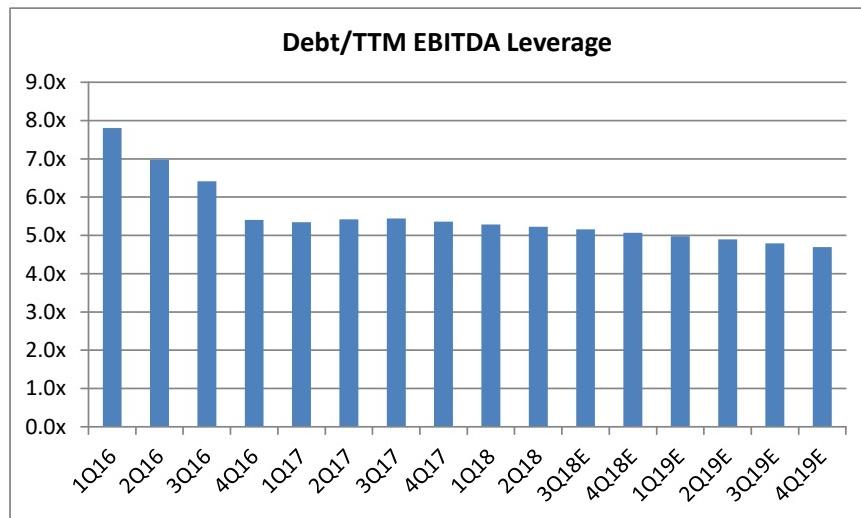
- Upside limited by a number of factors.** We believe uncertainty around Acadia's growth could create an overhang on the stock and limit upside to its valuation. Our view is based on the competitive environment as more behavioral/psychiatric beds in the industry could make it more difficult to increase occupancy rates. Coupled with the potential for fewer deals and potential changes in referral behavior because of alleged patient abuse at understaffed facilities, as well as limited visibility on growth and upside to Street estimates, we think ACHC's valuation will be range-bound.
- U.K. uncertainty remains an issue.** Last quarter, ACHC's U.K. operations generated 5.6% same-facility revenue growth, the best in two years, however labor cost pressures continued to plague EBITDA margin as salaries, wages & benefits expense increased 84 bps y/y. Despite expectations for growth in the U.K. coming from bed additions, ACHC still expects cost pressures from the labor shortages and use of temp staffing. We think the labor cost pressure in the U.K. and general uncertainty will continue until there is more clarity on Brexit in March 2019, which will make it difficult for the company to outperform expectations. Recent U.K. results also haven't instilled much confidence.
- Leverage remains high, creating other risks.** At the end of 2Q18, ACHC's debt/TTM EBITDA leverage ratio was 5.2x. In a rising interest rate environment, we think the company's leverage could make it more difficult to raise capital, or at a minimum, increase its cost of capital to do more deals to drive growth. With the higher leverage and limited visibility on growth, we think ACHC's valuation is capped.
- Lower estimates and price target to \$34.** While ACHC operates in a much needed and important industry, we think the increased risk profile and higher leverage will limit the stock's upside. Due to the competitive landscape, we made minor adjustments to our occupancy rate assumptions leading to lower revenue, EBITDA and EPS estimates. Based on this outlook, we lowered our price target to \$34 based on 9.0x our FY19 EBITDA estimate of ~\$677M. Our target multiple is near the lower end of ACHC's historical FY2 EV/EBITDA valuation, which we believe is justified given limited visibility on growth and ACHC's high leverage.

- **ACHC valuation likely capped.** Historically ACHC's trough FY2 EV/EBITDA valuation is in the 7.5x to 9.0x range and with the current leverage of 5.2x and rising interest rates, we think the stock's valuation will be range-bound around 9.0x.



Source: FactSet Data Systems and Craig-Hallum Capital Group, LLC estimates

- **Leverage remains high.** ACHC ended Q2 2018 with \$3,188M of long-term debt and \$33M of short-term debt leading to a leverage ratio of 5.2x, down modestly from 5.3x in 1Q18 and 5.4x in 2Q17. We think the company's high leverage in a rising interest rate environment will hamper its growth potential or at least reduce its return on invested capital as the cost of capital will be higher.



Source: FactSet Data Systems and Craig-Hallum Capital Group, LLC estimates

STOCK OPPORTUNITY

We are lowering our rating on ACHC to Hold from Buy and reducing our price target to \$34 (from \$44) based on an EV/EBITDA multiple of 9.0x our revised 2019 EBITDA estimate of \$676.5 million (net debt ~\$3,142M and 87.5M shares outstanding). Our target EV/EBITDA multiple is a discount to ACHC's historical FY2 average of ~11x, which we think is justified given the potential for growth to decelerate coupled with the company's high leverage (~5x) in a rising interest rate environment. While we like the long-term

opportunity for the behavioral/psychiatric industry, we think ACHC's leverage could make it more difficult to raise capital, or at least, increase its cost of capital as the company looks to do more acquisitions and the continued labor pressures in the U.K. could lead to higher operating costs.

RISKS

We believe an investment in Acadia Healthcare involves the following risks:

- **Concentrated Shareholder Base.** The top three shareholders of ACHC hold over 30% of the shares outstanding. If they chose to materially reduce their holdings, this may put downward pressure on the stock. Additionally, due to ACHC's limited float, this may add volatility to the stock.
- **Reimbursement.** Acadia receives a large portion of its revenue from government sources (Medicare, Medicaid, etc.). We are assuming modest pricing growth from Medicaid. If states reduce the number of Medicaid beneficiaries or reimbursement for behavioral health, this may adversely affect ACHC's revenue and margins.
- **Operational.** Like most healthcare services companies that derive a large amount of revenues from the government, there is a high level of operational scrutiny. It is important for the management of Acadia to adequately staff their facilities, bill for patient services correctly, maintain good recordkeeping, and operate their facilities for the benefit of their patients.
- **Headline.** Occasionally behavioral health facilities have negative news stories written about them and this can put negative pressure on the stock price of these companies. Sometimes there may be a government investigation opened to look into the allegations further and this can create uncertainty for investors.
- **Interest Rates.** Acadia frequently uses debt to finance acquisitions. We believe that about half of the company's debt has a fixed interest rate. However, if general market interest rates rise for a sustainable period, this may increase the interest expense for ACHC and adversely impact EPS growth.
- **Integration/Regulatory.** With the acquisition of Priory Group, ACHC will be exposed to certain integration and regulatory risks that they do not typically experience in the U.S. If the company does not properly integrate Priory Group, its profitability may suffer.

CRAIG-HALLUM
C A P I T A L G R O U P , L L C

Acadia Healthcare Company, Inc.

Income Statement (\$ millions, except per share amounts)

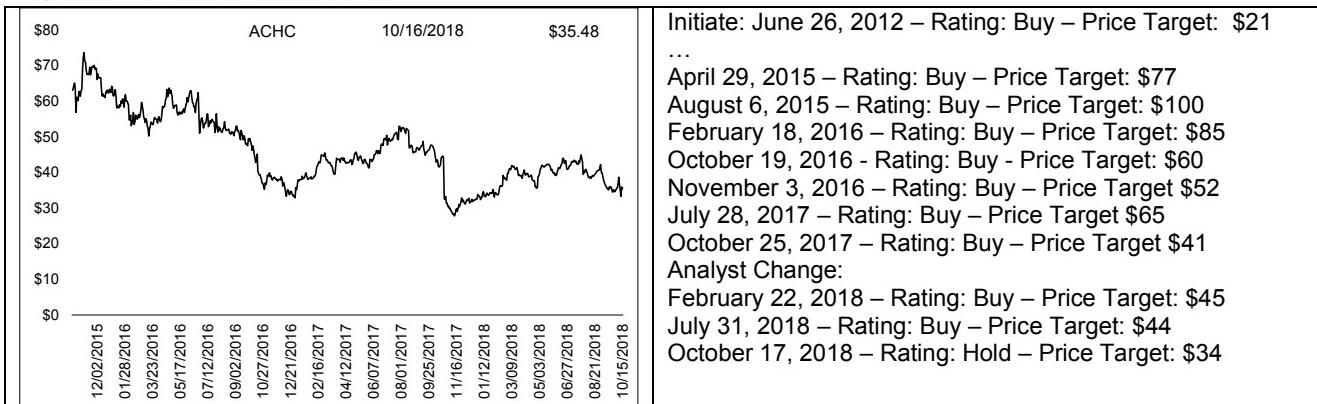
Period Ending	FY15	FY16	1Q17	2Q17	3Q17	4Q17	FY17	1Q18	2Q18	3Q18E	4Q18E	FY18E	1Q19E	2Q19E	3Q19E	4Q19E	FY19E	
Total Net Revenue	1,794.5	2,810.9	3,792	715.9	716.7	724.5	2,838.3	742.2	765.7	747.7	774.6	3,030.3	792.0	810.4	782.2	818.8	3,213.4	
Change, qtr/qtr	78.6%	56.6%	10.1%	-5.4%	-2.4%	3.1%	0.9%	9.3%	7.0%	4.3%	6.9%	6.8%	6.7%	5.8%	6.0%	5.7%	6.0%	
<u>Operating expenses:</u>																		
Salaries, wages and benefits	973.7	1,541.9	376.4	383.6	385.6	390.6	1,538.2	411.5	416.7	405.3	420.2	1,653.7	438.8	440.0	428.6	442.9	1,750.3	
Professional fees	116.5	185.5	43.4	46.3	53.0	53.5	198.2	54.0	53.5	55.7	58.1	221.3	58.6	55.1	58.2	59.8	231.7	
Supplies	80.7	117.4	27.7	28.6	28.7	29.4	114.4	29.4	30.1	29.9	31.0	120.4	31.7	32.0	31.7	32.8	128.1	
Rents and leases	32.5	73.3	19.0	19.4	19.0	19.3	76.8	20.3	20.2	19.4	19.9	79.9	21.8	21.9	21.4	22.1	87.2	
Other operating expenses	206.7	312.6	83.7	83.1	82.3	82.7	331.8	88.2	87.3	84.5	87.9	347.9	94.2	92.4	89.9	92.9	369.5	
Dépreciation and amortization	93.6	135.1	33.1	35.2	36.4	37.8	143.0	39.6	39.9	39.9	39.9	159.2	41.0	41.3	41.6	42.6	167.1	
Non-GAAP Operating Expenses	1,473.7	2,596.0	593.8	605.1	613.6	2,393.4	648.9	647.8	634.4	634.2	639.0	2,582.4	686.8	682.8	671.4	693.1	2,753.9	
GAAP Operating Income	271.5	214.3	91.2	109.7	106.0	105.9	412.8	93.3	115.1	108.3	113.6	430.3	100.3	122.6	115.8	120.7	459.5	
GAAP Operating Margin	15.13%	7.62%	13.43%	15.33%	14.79%	14.61%	14.55%	12.57%	15.03%	14.48%	14.65%	14.20%	12.67%	15.13%	14.62%	14.74%	14.30%	
Interest and other income:																		
Interest expense, net	106.7	181.3	42.8	43.5	44.5	45.2	176.0	45.2	45.8	47.5	47.5	186.1	48.0	48.0	48.0	48.0	192.0	
GAAP Pre-tax Income	164.8	33.0	48.5	66.2	61.5	60.6	238.8	48.1	69.3	60.8	66.1	244.2	52.3	74.6	67.8	72.7	207.5	
GAAP Pre-tax Margin	9.18%	1.17%	7.14%	9.25%	8.58%	8.37%	6.48%	9.04%	8.13%	8.55%	8.06%	6.61%	9.21%	8.56%	8.88%	8.32%	8.32%	
GAAP provision for income taxes	46.4	28.8	13.7	16.6	16.0	16.0	37.2	10.4	9.7	27.9	8.4	11.9	10.9	11.6	11.6	42.8		
GAAP tax rate	28.16%	87.33%	28.28%	25.04%	25.98%	-14.92%	15.71%	-5.79%	14.97%	16.00%	16.00%	16.00%	16.00%	16.00%	16.00%	16.00%	16.00%	
Non-GAAP provision for income taxes	62.4	55.5	12.9	18.8	17.0	13.1	61.9	8.5	10.9	10.5	11.2	41.2	9.2	12.7	11.7	12.4	46.0	
GAAP Income (Loss) from Continuing Operation	118.4	4.2	34.8	49.6	45.5	69.7	198.6	50.9	58.9	51.1	55.5	216.3	44.0	62.7	67.0	61.1	224.7	
Income (loss) from discontinued operations, net of tax	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
GAAP Net Income	(1.1)	(2.0)	0.0	34.8	49.6	45.5	69.7	198.6	50.9	58.9	51.1	55.5	216.3	44.0	62.7	57.0	61.1	224.7
Net income (loss) attributable to noncontrolling interest	(0.1)	(0.2)	0.0	0.1	0.1	0.1	(0.2)	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	
GAAP Net Income Attributable to Acadia	119.5	35.0	49.6	45.6	69.6	198.6	50.8	55.5	216.3	44.0	62.7	57.0	61.1	224.7	241.5	241.5	241.5	
Adjusted Income from Continuing Operations	152.8	210.2	39.9	57.2	50.2	52.9	200.0	45.2	61.2	55.3	58.9	220.6	48.2	66.9	61.2	65.3	241.5	
Adjusted Net Margin	8.51%	7.48%	5.87%	7.99%	7.01%	7.30%	7.05%	6.09%	7.99%	7.39%	7.60%	6.08%	8.25%	7.72%	7.97%	7.51%	7.51%	
Adjusted EPS	\$2.23	\$2.45	\$0.46	\$0.66	\$0.58	\$0.61	\$2.30	\$0.52	\$0.70	\$0.63	\$0.67	\$2.52	\$0.55	\$0.76	\$0.69	\$0.74	\$2.74	
Weighted average shares outstanding, diluted	68.4	86.0	86.9	87.2	87.2	87.0	87.3	87.5	87.6	87.7	87.8	87.5	87.5	87.5	87.5	87.5	88.2	
Stock-based compensation	20.5	28.3	7.4	7.4	4.2	4.5	23.5	6.9	7.1	6.5	6.5	27.0	7.5	7.5	7.5	7.5	30.5	
Adjusted EBITDA	404.8	608.6	136.4	162.2	152.3	153.5	604.1	145.7	159.4	164.0	634.1	150.4	176.5	189.9	175.8	676.5		
Margin Analysis:																		
Salaries, wages and benefits	54.26%	54.85%	55.42%	53.58%	53.80%	53.91%	54.16%	55.44%	54.42%	54.20%	54.25%	54.57%	55.40%	54.30%	54.10%	54.10%	54.47%	
Professional fees	6.49%	6.60%	6.39%	6.47%	7.40%	7.38%	6.92%	7.28%	6.98%	7.45%	7.50%	7.30%	7.40%	6.80%	7.35%	7.30%	7.21%	
Supplies	4.50%	4.18%	4.08%	4.00%	4.06%	4.00%	4.03%	3.96%	3.94%	4.00%	4.00%	3.97%	4.00%	3.95%	4.00%	4.00%	3.99%	
Rents and leases	1.81%	2.61%	2.71%	2.66%	2.67%	2.71%	2.73%	2.64%	2.60%	2.57%	2.64%	2.75%	2.70%	2.70%	2.70%	2.70%	2.71%	
Other operating expenses	11.52%	11.12%	12.33%	11.61%	11.49%	11.41%	11.70%	11.89%	11.40%	11.30%	11.35%	11.48%	11.90%	11.40%	11.35%	11.35%	11.50%	
Dépreciation and amortization	3.54%	4.81%	4.95%	4.92%	5.08%	5.21%	5.04%	5.36%	5.21%	5.30%	5.15%	5.25%	5.25%	5.10%	5.25%	5.20%	5.20%	
Non-GAAP Operating Expenses	88.12%	92.18%	85.96%	83.30%	84.42%	84.64%	84.56%	86.66%	84.82%	85.22%	86.70%	84.25%	84.75%	84.65%	85.08%	85.08%		
GAAP Operating Expenses	84.87%	92.38%	86.57%	85.21%	85.39%	85.47%	87.43%	85.80%	87.33%	84.87%	85.38%	85.26%	85.70%	85.70%				
Stock-based compensation as a % of salaries, wages and benefits	2.10%	1.84%	1.96%	1.94%	1.08%	1.14%	1.53%	1.68%	1.77%	1.60%	1.55%	1.64%	1.71%	1.70%	1.75%	1.66%	1.71%	
YY% Change:																		
Salaries, wages and benefits	69.2%	58.3%	10.4%	-6.0%	-5.6%	1.6%	-0.4%	9.3%	8.6%	5.1%	7.6%	7.7%	6.6%	5.6%	5.3%	5.4%	5.8%	
Professional fees	121.9%	58.3%	8.5%	-7.9%	-11.2%	12.5%	5.8%	24.4%	15.4%	5.0%	8.7%	12.8%	8.5%	3.1%	4.5%	2.9%	4.7%	
Supplies	66.6%	45.6%	3.8%	-8.2%	-6.2%	1.6%	-2.5%	6.0%	5.2%	4.4%	5.2%	7.9%	6.2%	6.0%	5.7%	6.4%	6.4%	
Rents and leases	125.5%	28.1%	-5.0%	-3.5%	5.4%	6.9%	4.7%	6.9%	4.1%	3.0%	4.0%	7.4%	8.1%	10.0%	11.1%	9.1%	9.1%	
Other operating expenses	86.8%	51.2%	19.2%	3.2%	1.3%	1.2%	6.2%	5.4%	5.0%	2.6%	6.3%	4.8%	6.8%	5.8%	6.4%	6.2%	6.2%	
Dépreciation and amortization	94.5%	112.6%	4.2%	-0.1%	11.2%	5.9%	18.3%	13.4%	5.7%	11.3%	4.5%	4.5%	3.5%	5.0%	6.7%	4.9%	4.9%	
GAAP Operating Income	55.7%	(21.1%)	30.0%	(10.5%)	NM	19.7%	2.3%	4.9%	2.2%	7.3%	4.2%	7.5%	6.6%	7.0%	6.3%	6.8%	9.5%	
Adjusted Income from Continuing Operations	45.3%	9.5%	(13.0%)	(9.4%)	0.6%	3.0%	(6.0%)	12.8%	6.2%	10.0%	11.3%	10.3%	5.7%	8.6%	9.9%	10.1%	8.7%	
Adjusted EPS	4.1%	(2.3%)	2.7%	2.7%	6.9%	1.7%	6.8%	4.7%	6.0%	6.0%	6.8%	6.8%	6.9%	6.9%	6.8%	6.7%	6.7%	
Adjusted EBITDA	50.3%	87.9%	(5.8%)	(2.3%)	2.7%	6.8%	4.9%	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	6.8%	

Source: Company data and Craig-Hallum Capital Group, LLC, estimates

Craig-Hallum Capital Group
Kevin Ellitch | (612) 334-8228

October 16, 2018

REQUIRED DISCLOSURES



Source: FactSet

Ratings definitions:

Buy rated stocks generally have twelve month price targets that are more than 20% above the current price. **Hold** rated stocks generally have twelve month price targets near the current price. **Sell** rated stocks generally have no price target and we would sell the stock.

Fundamental trend definitions:

Improving means growth rates of key business metrics are generally accelerating. **Stable** means growth rates of key business metrics are generally steady. **Mixed** means growth rates of some key business metrics are positive but others are negative. **Declining** means growth rates of key business metrics are generally decelerating.

Ratings Distribution (9/30/2018)

Rating	% Of Companies Covered	% With Investment Banking Relationships
Buy	77%	18%
Hold	21%	2%
Sell	1%	0%
Total	100%	14%

Information about valuation methods and risks can be found in the “STOCK OPPORTUNITY” and “RISKS” sections, respectively, of this report.

CHLM makes a market in this security.

CHLM expects to receive or intends to seek compensation for investment banking services from the subject company in the next three months.

Analysts receive no direct compensation in connection with the firm's investment banking business. Analysts may be eligible for bonus compensation based on the overall profitability of the firm, which takes into account revenues from all of the firm's business, including investment banking.

OTHER DISCLOSURES

Although the statements of fact in this report have been obtained from and are based upon recognized statistical services, issuer reports or communications, or other sources that Craig-Hallum believes to be reliable, we cannot guarantee their accuracy. All opinions and estimates included in this report constitute Craig-Hallum's judgment as of the date of this report and are subject to change without notice. Craig-Hallum may effect transactions as principal or agent in the securities mentioned herein. The securities discussed or recommended in this report may be unsuitable for investors depending on their specific investment objectives and financial position. This report is offered for informational purposes only, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such would be prohibited. Additional information available upon request. Member SIPC.

REGULATION AC CERTIFICATION

I, Kevin Ellich, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject security and issuer. No part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views contained herein.